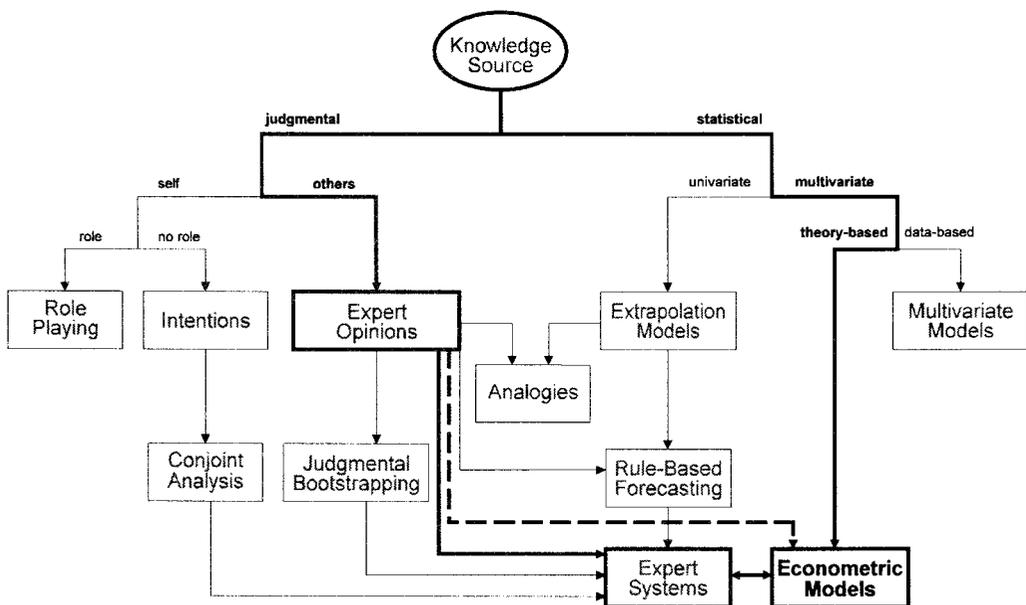


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## ECONOMETRIC METHODS

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Econometric methods rely on statistical procedures to estimate relationships for models specified on the basis of theory, prior studies, and domain knowledge. Given good prior knowledge about relationships and good data, econometric methods provide an ideal way to incorporate expert judgment and quantitative information. As implied by their name, econometric methods were developed primarily by economists, but other disciplines have also contributed to the methodology. Certainly their use extends beyond economics.

In "Econometric Forecasting," Geoff Allen from the University of Massachusetts and Robert Fildes from the University of Lancaster describe principles for how and when to use econometric methods. For example, one should estimate equations in levels, not in first differences. The authors are ambitious in that they provide the most recent principles proposed by leading econometricians. The downside of these recent developments is that much of the work is speculative. Also, because of their complexity, some proposed principles seem risky. However,

forecasters who follow the basic principles should generally be more accurate than those who do not.

A good question to ask econometric model builders would be, "Could a simpler model do just as well?" While simplicity is a principle that extends to all forecasting methods, complexity can easily get out of hand in econometrics. Still, some complexity is called for.

Allen and Fildes show that econometric models are more accurate than other

methods for long-range forecasts. Evidence also suggests that the principles described for econometric methods can improve short-term forecasts.

While the authors examine primarily time-series data, work has also been done on econometric models for cross-sectional data. Many of the principles apply to both types of data, for example, to use theory and domain knowledge to select variables, to include all important variables, and to keep each model simple.

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